

October 20, 2016

**VIA ECFS**

***NOTICE OF EX PARTE***

Ms. Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12th Street, SW, Room TW-A325  
Washington, DC 20554

**Re: *Business Data Services in an Internet Protocol Environment, WC Docket No. 16-143; Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans, WC Docket No. 15-247; Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25; AT&T Corporation Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM-10593***

Dear Ms. Dortch:

On October 18, 2016, Joe Cavender of Level 3 Communications, LLC (“Level 3”) and I met with Deena Shetler, Pam Arluk, David Zesiger, William Kehoe, Billy Layton, Christine Sanquist, Joseph Price, and Richard Benson, all of the Wireline Competition Bureau, and on October 20, 2016, Mr. Cavender and I met with Travis Litman, Senior Legal Advisor to Commissioner Rosenworcel, and Mr. Cavender met with Amy Bender, Legal Advisor to Commissioner O’Rielly. In the meetings we discussed the Chairman’s proposal for reforming the regulatory framework for business data services, as set forth in the recently released Fact Sheet.<sup>1</sup> We expressed Level 3’s support for the Chairman’s proposal to apply ex ante rate regulation to DS1 and DS3 business data services provided by incumbent LECs. We also argued that the Commission should adopt the changes to the Chairman’s proposal discussed below, but we emphasized that the Commission should adopt the Chairman’s proposal even if it does not adopt these changes.

***DSn services.*** We argued that it would be appropriate for the Commission to require that incumbent LECs file tariffs needed to comply with the reduction in the price cap index caused by the elimination of Phase II pricing flexibility and the one-time downward adjustment of the X Factor as soon as possible (e.g., 30 days from publication of the Commission order in the Federal

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<sup>1</sup> *Fact Sheet: Chairman Wheeler’s Proposal to Promote Fairness, Competition, and Investment in the Business Data Services Market* (rel. Oct. 7, 2016), [http://transition.fcc.gov/Daily\\_Releases/Daily\\_Business/2016/db1007/DOC-341659A1.pdf](http://transition.fcc.gov/Daily_Releases/Daily_Business/2016/db1007/DOC-341659A1.pdf).

Register). In addition, the downward adjustment to the X Factor should be phased in over two, not three, years. These modifications to the Chairman's proposal will ensure that incumbent LECs do not charge unlawful rates any longer than is necessary.

The Commission also should mandate a "fresh look" opportunity under which customers are given 180 days to cancel, without incurring early termination penalties, existing tariff plans and commercial agreements that affect the rates, terms, and conditions on which incumbent LECs offer DS1 and DS3 services. A fresh look opportunity will ensure that the prescribed rate adjustments take effect in a timely manner. In addition, it will reduce the likelihood of unreasonable discrimination that would otherwise occur as a result of the fact that some customers would be unable to take advantage of lower prices under existing contract tariffs and commercial agreements whereas other customers would be able to take advantage of lower prices. A fresh look opportunity is reasonable because customers entered into existing contract tariffs and commercial agreements based on the assumption that they would be required to pay the then-applicable rates for the relevant services. As a result, customers likely agreed to many terms and conditions to which they would not have agreed if the adjusted rates had applied.

A fresh look comports with established principles governing the retrospective effect of agency decisions. For example, in the analogous context of a declaratory ruling, the presumption of retrospective effect is so strong that in order for a declaratory ruling not to have that effect the agency must conclude that manifest injustice would result.<sup>2</sup> Here, the incumbent LECs' only arguments against providing a fresh look are without merit. *First*, the incumbent LECs' argument that parties bargained for the agreements in question is irrelevant because, as explained, parties did so under a pricing regime that failed to discipline incumbent LEC market power, and there is no meaningful "bargain" between a seller with market power and a buyer. *Second*, incumbent LECs' desire to minimize the impact of the rate adjustments on their profit margins is the type of rationale that has been found inadequate in the declaratory ruling context.<sup>3</sup>

***Low-bandwidth Ethernet.*** We also explained that the market for Ethernet of 50 Mbps and below ("low-bandwidth Ethernet services") is very similar to the market for DS1 and DS3 services, and there is no basis in the record for the Commission to decline to apply ex ante rate regulation to low-bandwidth Ethernet services. *First*, the structure of the markets for DS1 and DS3 services and low-bandwidth Ethernet services is essentially the same. As Prof. Marc Rysman's analysis of location data demonstrates, only about one percent of buildings are served by more than two business data services competitors.<sup>4</sup> In addition, an analysis prepared by Level 3's John Merriman shows that it is infrequently feasible for Level 3 to deploy connections at 100

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<sup>2</sup> *Am. Tel. & Tel. Co. v. FCC*, 454 F.3d 329, 332 (2006); *see also Qwest Servs. Corp. v. FCC*, 509 F.3d 531, 539-41 (2007).

<sup>3</sup> *See, e.g., Qwest Servs. Corp.*, 509 F.3d at 540-41.

<sup>4</sup> *See* Marc Rysman, *Empirics of Business Data Services*, at 15, tbl. 7 (rev. June 2016), [https://apps.fcc.gov/edocs\\_public/attachmatch/DOC-340040A6.pdf](https://apps.fcc.gov/edocs_public/attachmatch/DOC-340040A6.pdf).

Mbps or below.<sup>5</sup> Competitive LECs including Windstream and TDS have reached similar conclusions.<sup>6</sup> We noted that incumbent LECs have failed entirely to challenge these conclusions and have not offered any deployment analyses of their own. We also observed that for decades the Commission has relied on market structure analysis in determining whether to apply ex ante rate regulation, and such analysis provides a fully sufficient basis for the adoption of ex ante rate regulation of low-bandwidth Ethernet services.

*Second*, Prof. Jonathan Baker's regression analysis shows DS1 price reductions in response to rivalry of 51 percent according to one estimate and of 42 percent according to another estimate.<sup>7</sup> To the extent that price reductions have not been observed for low-bandwidth Ethernet services, that is almost certainly because incumbent LECs sought to protect DS<sub>n</sub> prices in 2013 by maintaining rather than reducing low-bandwidth Ethernet prices. That incumbent LECs have market power in the provision of low-bandwidth Ethernet services is confirmed by the fact that Prof. Baker observed reductions in incumbent LEC prices for high-bandwidth connections (those above 50 Mbps) of 43 percent according to one estimate and of 25 percent according to another estimate.<sup>8</sup> The evidence in the record indicates that deployment of high-bandwidth services is generally more feasible than deployment of low-bandwidth services<sup>9</sup>—and thus that prices for high-bandwidth services are likely subject to greater competitive discipline. Accordingly, one would expect to observe similar or greater price reductions for low-bandwidth services were incumbent LECs not avoiding rate reductions to protect DS<sub>n</sub> prices. We also explained that pockets of competition in the provision of both low-bandwidth Ethernet services and DS<sub>n</sub> services are likely limited to a very small number of buildings. Thus, a national finding of non-competition is as appropriate for low-bandwidth Ethernet services as it is for DS<sub>n</sub> services.

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<sup>5</sup> Declaration of John Merriman on Behalf of Level 3 Communications, LLC, ¶ 6 (June 27, 2016), attached to Comments of Birch, EarthLink and Level 3, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593 (filed June 28, 2016) ("Merriman Decl.").

<sup>6</sup> See, e.g., Declaration of David Schirack and Mike Baer, ¶¶ 16-18 (June 28, 2016), attached as Attachment A to Comments of Windstream Services, LLC, WC Docket Nos. 16-143 & 05-25, RM-10593 (filed June 28, 2016); Third Declaration of Matthew J. Loch, ¶ 13 (Feb. 19, 2016), attached as Attachment A to Reply Comments of TDS Metrocom, LLC, WC Docket No. 05-25, RM-10593 (filed Feb. 19, 2016).

<sup>7</sup> Reply Declaration of Jonathan B. Baker on Competition and Market Power in the Provision of Business Data Services, ¶ 13 n.31, attached to Letter from Jonathan B. Baker to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 16-143, 15-247, & 05-25, RM-10593 (filed Aug. 9, 2016).

<sup>8</sup> *Id.*

<sup>9</sup> See, e.g., Merriman Decl. ¶ 6.

We further explained that the application of rate regulation to low-bandwidth Ethernet services is straightforward. The Commission should reduce incumbent LEC prices for low-bandwidth Ethernet services by 19.7 percent, consistent with price reductions in response to competition observed in the regressions. But even if the Commission does not do so, the Commission could at least apply ex ante regulation to low-bandwidth Ethernet at current prices.

The Commission also should bring low-bandwidth Ethernet services within the price cap regime. Price caps were designed to accommodate circumstances such as those present here in which competition is nascent or in which there are pockets of competition, and where costs vary from area to area.<sup>10</sup> Price caps are, without question, administrable, well understood, and effective—and they meet the criteria that Commissioners Clyburn and Rosenworcel identified in their *FNPRM* statements.<sup>11</sup>

Price caps create an incentive for incumbent LECs to invest by providing more flexibility and more certainty than either benchmarks or a complaint-based process. They also ensure that incumbent LECs can set prices appropriately to match costs with a reasonable return on investment and to respond to competition, all at lower costs than a complaint-based process would provide. If price caps are applied to low-bandwidth Ethernet services, competitive LECs also will be better able to invest, for example, in deploying fiber to serve multi-location customers in cases where some customer locations must nevertheless be served using off-net facilities. In addition, the reduction in incumbent LEC rent extraction that will result from the application of price caps to low-bandwidth Ethernet services will enhance competition both from facilities-based providers like Level 3 and from those providers that are more reliant on off-net solutions. Moreover, as mentioned, price cap regulation is an administrable solution for the Commission, for carriers subject to price caps, and for customers large and small.

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<sup>10</sup> See *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd. 6786, ¶ 355 (1990); *Expanded Interconnection with Local Telephone Company Facilities; Amendment of the Part 69 Allocation of General Support Facility Costs*, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd. 7369, ¶¶ 172, 177-179 (1992) (density zones); *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers; Petition of U.S. West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix Arizona MSA*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd. 14221, ¶ 128 (1999) (contract tariffs).

<sup>11</sup> See *Business Data Services in an Internet Protocol Environment; Investigation of Certain Price Cap Local Exchange Carrier Business Data Services Tariff Pricing Plans, Special Access for Price Cap Local Exchange Carriers, AT&T Corporation Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Tariff Investigation Order & Further Notice of Proposed Rulemaking, 31 FCC Rcd. 4723, Statement of Commissioner Mignon L. Clyburn (2016); *id.* Statement of Commissioner Jessica Rosenworcel.

Finally, we explained that because price caps clearly provide the best, most realistic option for setting low-bandwidth Ethernet price levels, they should be adopted now. While the Commission invited comment on a variety of alternative approaches in the *FNPRM*, the record in these proceedings has only confirmed the Commission's initial observation that "[w]e are not aware of any other presently available alternative to price cap regulation that more effectively balances the interests of ratepayers and carriers."<sup>12</sup> The Commission should not further extend these proceedings in order to reach a conclusion about the appropriateness of price cap regulation that it first reached more than 25 years ago and that has continued to be true since.

Please do not hesitate to contact me if you have any questions or concerns regarding this submission.

Respectfully submitted,

/s/ Thomas Jones

Thomas Jones

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cc: Travis Litman  
Amy Bender  
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<sup>12</sup> *Id.* ¶ 354.